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Internal audit activities in 2001**

Summary

The present report from the Office of Internal Audit (OIA) is the fifth annual report to the Executive Board on UNICEF internal audit activities. It describes the audit methodologies and areas covered during field office audits and the criteria for the issuance of audit ratings. In addition, this year's report provides expanded coverage of management actions to address OIA recommendations throughout the year.

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I. Introduction

1. The Office of Internal Audit (OIA) completed 30 audits in 2001, including three audits at headquarters locations. Controls generally were found to be satisfactory, no location was found to be unsatisfactory in all audited areas, and management actions to address audit recommendations were good in most offices.

2. A quality assurance review by the Institute of Internal Auditors found that OIA meets the standards for the practice of internal auditing. In 2001, OIA began systematically to review programme management controls in its field audits, and significantly strengthened its audits of financial controls and cash assistance.

II. Accountability, strategy and resources of the Office of Internal Audit

A. Accountabilities and oversight

3. OIA fulfilled its accountabilities (defined in E/ICEF/1997/AB/L.12) in 2001 through the implementation of an office management plan that defined internal improvement priorities, and an audit plan that defined priority locations and issues to be audited during the year. The audit plan was reviewed by the Audit Committee at the outset of the year and at each meeting of the Committee throughout the year.

4. The Institute of Internal Auditors conducted an independent quality assurance review of the UNICEF audit function in November 2001. The Institute concluded that " ... the work performed by the UNICEF Office of Internal Audit was in accordance with the standards for the professional practice of internal auditing". The review included several recommendations, including reducing the time required to issue audit reports, enhancing recommendations for follow-up and increasing the coverage of headquarters and information technology issues. A number of the review's recommendations already have been addressed and the others are in progress. The Audit Committee monitors implementation of the recommendations, and a status report will be included in the next annual report by OIA to the Executive Board.

5. Oversight of the audit function in UNICEF was strengthened in 2001 through the expansion of the Audit Committee to include the Director of the Office of Audit and Performance Review of the United Nations Development Programme as an external member. This selection provides both independent and professional audit support to the Committee and practical input from the Director of Audit of a United Nations fund with a similar scale and field presence.

B. Audit strategy and approach in 2001

6. New field audit guidelines were launched at the beginning of the year for the assessment of financial controls, programme management controls and cash assistance. Each guideline follows a detailed work process approach which profiles the key controls that are expected to exist in a well-managed field office and provides guidance to the auditors on how the functioning of each control can be assessed. The new guidelines complete a package which also includes supply

assistance and consultancy contract management, thus assuring systematic coverage of the major financial and programme controls in each field office audit.

7. OIA continues to expand the use of data extraction and analysis software to increase the efficiency and effectiveness of audits. In 2001, OIA was awarded the grand prize from a leading audit software firm for application development from among 150 international entries. The award cited OIA efforts to standardize and simplify the procedures for running the software so that auditors can use the tool without specialized computer knowledge. As a result of this application, OIA field audits systematically examine the entire computer-based transaction records of an office for the period under review to identify areas of potential risk.

8. The audit report format was revised in 2001 so that each audit finding includes a description of the immediate risks that management faces due to the identified control weakness. The OIA reporting options were expanded to include a management memo which is used to direct minor findings to the head of the audited office. As a result, the formal audit report, which is presented to the Executive Director, concentrates on important audit findings that should be brought to the attention of senior management.

9. The audit reports include risk management ratings that summarize the view of OIA of the quality of an office's risk management practices in each of the audited areas. OIA does not consolidate its views into a single rating of an office's overall performance, as one rating would mask the complexities and differences in the various areas covered in a typical audit. Unsatisfactory ratings do not indicate a supposition of fraud or loss of UNICEF resources. Rather, they indicate that the office's controls over one or more risks to the achievement of its programme and/or procedural and compliance objectives were seriously weak and should be strengthened.

10. OIA uses a three-point scale to rate an office's risk management practices in each audited area:

(a) *Exemplary*. All control functions were as expected and no uncontrolled risks were identified;

(b) *Satisfactory*. All aspects were functioning well, although one or more management practices could be improved to strengthen further the potential for achieving the performance and/or compliance objectives of the audited area;

(c) *Unsatisfactory*. Important weaknesses in the office's risk management practices were identified which significantly reduce the office's potential to achieve its performance and/or compliance objectives in the audited area. Priority attention is required by management to establish effective controls.

11. Consistency and quality assurance of audit coverage, risk statements and ratings, and the use of the audit report or management memo to present the findings are maintained through a review process within audit teams and by OIA management. Audit ratings are issued by the Director of OIA, and are only given when the audit has completed adequate coverage of an area to be able to form an overall opinion. In 2001, there were three instances when ratings were not given due to limited coverage.

12. To strengthen field offices' understanding and application of financial controls, most audit teams conducted a one-day participatory session on key concepts and

UNICEF standards which facilitated the office's own assessment of its table of financial authorities. This advisory action, which is distinct from the audit, provides an opportunity for field staff to benefit from the auditors' knowledge of financial control systems.

III. Results of work undertaken in 2001

A. Audit coverage

13. OIA completed 30 audits in 2001 against an original target of 38. Coverage fell short due to four staff vacancies in the third quarter (three staff members transferred to other posts within UNICEF and the fourth went to another United Nations internal audit service), in addition to security conditions in the last quarter of the year, which led to the postponement of three audits in Central and Eastern Europe, the Commonwealth of Independent States and the Baltic States, and in the Middle East and North Africa, and an investigation which required four person-months of input from two senior auditors.

Table 1
Audit coverage, 2000 and 2001

	2000	*2001*
Total audits	40	30
Field offices	34	27
Total recommendations issued	2 102	1 481
Audit report recommendations		1 222
Management memo recommendations		259

14. OIA continued to ensure that draft field audit reports were issued and discussed before the team's departure from the audit location. This is a demanding standard, but provides assurance that draft audit observations are accurate and understood by management. However, as a result of major changes in 2001 (new audit guidelines, risk-based reporting format, electronic work paper software, and increased attention to quality assurance in report content and performance ratings), the average release of final reports continued the pattern of previous years of exceeding five months after the completion of the audit. [This has been addressed in 2002, and in the first round of audits, five of the six reports were issued in less than eight weeks after the end of the field work. Performance for the full year will be presented in the next OIA annual report to the Executive Board].

B. Field offices

15. New as of 2001, the scope of each field audit includes a detailed assessment of the core control areas of finance and programme management. Additional areas are determined based on a review of the office's performance data to identify areas of high value and potentially significant risk. As a result, most field audits included reviews of supply and cash assistance, and consultancy contract management.

Individual audits also covered other areas that were considered relevant to the circumstances. Combined, the audited areas systematically assessed approximately 85 per cent of the means through which UNICEF resources were planned, committed and used. This targeted and detailed process covered close to 100 per cent of the areas of significant potential risk in each office.

Programme management

16. The field audits reviewed the existence and functioning of offices' controls over the major management risks to the achievement of their programme objectives. Each audit assessed how an office defines and ensures the quality of its annual programme plans; the functioning of the office governance process to maintain attention to the programme and office priorities; management's monitoring of office performance; the functioning of programme monitoring and evaluation systems; staff capacity and training in core programme management skills; and the accuracy of the performance reports presented to headquarters and regional offices.

17. The basic programme management controls were systematically reviewed in 22 offices, and in 18 the overall controls were found to be satisfactory. The unsatisfactory offices demonstrated weaknesses across several control areas. Areas for improvement among a number of the satisfactory offices were generally consistent with those for the unsatisfactory offices but were not as strong or frequent.

18. The development of clearly defined annual project plans of action was weak in a number of offices, and there were considerable limitations in offices' use of the Programme Manager System (ProMS) facilities to generate performance management reports. While country management teams exist in all satisfactory offices, nearly one half were not fulfilling their defined role of monitoring programme implementation. There were considerable limitations in field monitoring of UNICEF-supported activities, and unsatisfactory offices did not have integrated monitoring and evaluation plans.

Finance and accounts

19. The audit guideline for the review of finance and accounts was restructured at the beginning of 2001 to ensure a systematic review of the major controls over the commitment and expenditure of UNICEF funds within field offices. Each audit assesses the controls in the assignment and exercise of financial authorities, the functioning of the contract review committee, the processing of payments, the safeguarding of financial instruments and records, the logical access to ProMS and management's awareness of the functioning of the finance controls.

20. These controls were reviewed in 26 field offices, 20 of which were found to have satisfactory risk management practices. The six unsatisfactory offices generally demonstrated weaknesses in understanding among staff with financial control responsibilities of their roles and how to implement them, and some inconsistencies between the financial authorities defined by the head of the office and those established in ProMS. The actual payment processing controls generally functioned well, even in most of the offices that were rated as unsatisfactory. However, not all offices have appreciated the risks associated with weak controls over access to ProMS. There were weaknesses in the bank reconciliation process in some offices.

21. The control environment over significant commitments of UNICEF funds (above $20,000 in most field offices) to external parties was considerably strengthened at the end of 2001 through revised contract review procedures issued by the Division of Financial and Administrative Management (DFAM) which require all proposals for commitments to external parties (through consultancy contracts, supply purchase orders, cash assistance and support to non-governmental organizations (NGOs)) to be submitted to a contract review committee for assessment before they can be authorized for issue. This new procedure is expected to address some of the common weaknesses that were identified in the management of programme inputs in a number of field offices as noted in the following section.

Input management

22. Following an assessment of the office's performance data and reports, discussions with headquarters and regional office staff and interviews within the audited office, OIA selected for audit one or more of the three key means through which the office plans, commits and procures programme and office inputs: cash assistance, supply assistance and consultancy contract management. Most field audits in 2001 addressed all three input areas.

Cash assistance

23. Revised audit guidelines for the assessment of cash assistance were developed at the beginning of 2001 based on the financial circular that governs cash assistance. Each audit of cash assistance reviewed the planning process, budgeting for specific activities, the disbursement process, reporting on use by counterparts and monitoring and assessment by UNICEF of counterparts' use of cash assistance to Governments.

24. In 2001, cash assistance was reviewed in 25 field audits using the new guidelines. In 13 locations, controls were found overall to be unsatisfactory. While most offices did secure timely financial reports from counterparts, frequently occurring weaknesses included the authorization of poorly prepared requests from counterparts, the acceptance of financial reports without (or with poor quality) activity monitoring reports from counterparts, and limited firsthand awareness among staff of the effectiveness of cash assistance due to weak guidance on what to look for during field visits. Unsatisfactory offices had weak knowledge of counterparts' administrative and accounting capacities to handle cash assistance and a tendency to release a significant share of the total year's cash assistance in the last quarter of the year.

Supply assistance

25. Supply assistance was reviewed in 24 field locations where it was a significant component of the programme of cooperation. The audits followed a detailed audit guideline that was developed in consultation with Supply Division, which supported the systematic assessment of the controls over supply planning, specification development, the identification of suppliers, the contracting process, pre-delivery quality assurance and the receipt of deliveries, and assessing the effectiveness of supply assistance.

26. Eighteen offices were found to have satisfactory control over the range of risks to supply assistance management. However, the existence of a significant number of the following common risks led to unsatisfactory ratings in six offices; some of these risks were also found in a number of the offices that generally had satisfactory risk management practices.

27. Common control weaknesses included weak definitions of supply requirements in annual plans, which often resulted in delays in procurement action until late in the year; the lack of pre-assessed lists of suppliers, which led to assessments of potential suppliers on a case-by-case basis for each procurement action; and weak awareness among staff of the actual use of supplies provided by UNICEF in the field. Less common were weaknesses in specification development, generally in the requests from counterparts, which increased the risk that incorrect items would be procured and that there would be a lack of comparability in the bids from potential suppliers.

Contracts for services

28. In 13 of the 19 locations where the management of consultancy contracting was assessed, the offices' risk management practices were satisfactory. Each audit assessed the functioning of controls to determine that consultancy support was required, how terms of reference were defined, the processes for identifying potential candidates and selecting from among them, the issuance of contracts, and the supervision and evaluation of performance.

29. One office was rated as exemplary for maintaining fully functioning controls in all areas. Common risks that were often found among the six unsatisfactory offices included a strong reliance on single-source selection of consultants, and weak supervision and evaluation practices. The quality of terms of reference was found to be generally better than in earlier years, but the definition of deliverables remained weak in some locations.

Safety and security

30. In the fourth quarter of 2001, OIA introduced an assessment of audited offices' safety and security controls and procedures for staff and offices. Combined with the reviews of emergency management procedures that were already being implemented in emergency locations, the safety and security controls were assessed in nine locations in 2001.

31. Overall, controls were found to be satisfactory in eight offices. Inadequately controlled risks that were found in more than one location include weak fire protection systems and procedures, inadequate office and vehicle telecommunications equipment, and inadequate electronic data back-up and off-site storage practices.

32. Audit coverage of this subject continues in 2002 and OIA will issue a summary report of key findings based on the combined findings from 2001 and 2002.

Analysis of audit findings: underlying causes from field offices

33. From 2001, all audit observations are classified by OIA according to an internationally recognized control framework to establish an understanding of the underlying issues associated with the audit findings. Table 2 shows that over 70 per

cent of the control weaknesses are due to weaknesses in staff practices or management's monitoring of those practices, and lack of procedural guidance. The remaining 27 per cent of underlying causes are disbursed among 15 other classifications.

Table 2
Major underlying causes for field audit observations in 2001

Reason for weaknesses in risk management practices	*Percent of total*
Poor quality implementation of defined procedures	40
Lack of defined procedures	22
Office management not monitoring the functioning of the control	11

34. Generally, control procedures have been defined for most aspects of field office operations, either by headquarters or by individual field offices (to address local needs), with notable exceptions in the areas of: guidance for the implementation of field monitoring (which affects programme management, and cash and supply assistance); information from field offices to counterparts on standards for requesting and reporting on cash assistance; and field offices' internal review processes for the assessment of cash assistance requests and liquidations.

35. The most prevalent underlying cause of inadequate control is weakness in offices' implementation of established procedures, which indicates a general need for continued improvements in staff awareness and skills in the application of procedures and increased attention to quality control by management. Appropriate recommendations were issued to address these underlying causes of control weaknesses.

C. Headquarters locations and systems audits

Supply Division, Copenhagen — Finance, Budget and Accounts Centre

36. OIA reviewed all major finance and budget processes within the Division's Finance, Budget and Accounts Centre, and found them to be satisfactory in support of UNICEF global supply and procurement operations. The audit found that Supply Division had been active in assessing its own conditions and was aware of areas for improvement, but had not addressed a number of its own suggestions. Recommendations were made to seek efficiencies in the flow of documentation from freight forwarders, to improve the generation and use of procurement service performance reports, and to strengthen reporting to procurement service customers. Supply Division has accepted all 13 recommendations; four were closed by June 2002, and management has demonstrated that action is being taken to address the other nine.

Supply Division, Copenhagen — Procurement

37. The audit reviewed the controls over procurement planning, bidding, supplier selection, the issuance of purchase orders, management of long-term agreements, internal information and communication and management reporting. The controls in all areas were found to be satisfactory except over the issue of low-value purchase

orders, and recommendations were made to strengthen the documentation of the supplier selection and contracting process. Supply Division is addressing all 34 audit recommendations; 18 are closed, including one of the two related to improving documentation of low-value procurement activities. The other recommendation is of an ongoing nature and is being implemented.

Financial and Logistics System — Security, Authorizations and Interfaces

38. An audit team conducted a 99 person-day review of the Financial and Logistics System (FLS) at headquarters and concluded that the controls over access security, and the management of the interfaces between FLS and ProMS, the Integrated Management Information System and other systems were satisfactory. Recommendations were made to establish a mechanism to identify and investigate any attempted security violations and to strengthen the effectiveness of the controls that limit the period of users' access to the system. The audit included 18 recommendations, of which 12 have been closed and six are being addressed.

D. Investigation support

39. An investigation was conducted in the UNICEF office in Indonesia following concerns about local supply procurement raised by the office. Consistent with the OIA investigation strategy, auditors reviewed the functioning of all controls associated with procurement and investigated the allegations. Investigation support was also secured from the United Nations Office of Internal Oversight Services. The investigations did not establish that any UNICEF staff had been involved in procurement irregularities, although the audit of controls in procurement, cash assistance and fund-raising established serious weaknesses in the application of UNICEF procedures and a failure to implement past audit recommendations. Management is taking action to strengthen controls in the identified areas and is pursuing recoveries from a supplier.

IV. Implementation of recommendations by management

40. The standard period for the first formal reply on actions taken to address the audit recommendations is two months after the issuance of the final report. For the 2001 audits, the first implementation report was received on or within one month of the deadline from all but three audited offices, and all but one auditee had responded as required as of July 2002.

41. OIA has significantly strengthened its attention to recommendation follow-up and maintaining awareness of management actions to address issued recommendations. The status of over 5,000 recommendations has been reviewed and systems are now in place to maintain an up-to-date profile of open and closed recommendations.

Table 3
Status of audit recommendation closure, 1999-2001
(as of 1 July 2002)

Year of audit	Number of audits	Number of offices by per cent of recommendations closed			
		All	> 90%	76%-89%	< 75%
1999	42	17	10	9	6
2000	40	17	14	5	4
2001	30	0	3	10	17*

* Of these 17 audits, reports were not due from six at the time this report was written.

42. The six field offices with unsatisfactory ratings in all audited areas that were noted in the 2000 annual report have responded to the audit recommendations and in three of the offices, all recommendations have been addressed and are closed. In the other three offices, over 90 per cent of the recommendations are implemented and the balance are in the process of being implemented.

43. While OIA audit testing and the quality assurance over risk ratings and recommendations were strengthened in 2001, no field office was found to be unsatisfactory in all areas. Nine offices had satisfactory controls in all audited areas, and another nine offices were satisfactory in all but one area. Only two offices were found to be unsatisfactory in more than 50 per cent of the audited areas.

44. As demonstrated in table 4, OIA is satisfied that all but one of the field offices with multiple unsatisfactory ratings have taken timely actions to establish controls in areas of weak performance. In most instances, the open recommendations require actions that can only be confirmed as completed at the end of 2002 or are complicated recommendations that require the offices to secure changes in procedures with counterparts.

Table 4
Field locations with more than one unsatisfactory rating in 2001 and status of actions taken by management to strengthen controls
(as of 1 July 2002)

Location	Rated areas		Percentage of total recommendations closed	Number of open recommendations
	Total areas rated	Unsatisfactory		
Islamic Republic of Iran	7	5	77%	10
United Republic of Tanzania	6	4	77%	13
Costa Rica	5	3	81%	9
Somalia	6	3	90%	5
Malawi	6	3	93%	4
Ecuador	6	3	Replies not due as of date when 2001 annual report was completed.	
Burkina Faso	5	3		

Location	Rated areas		Percentage of total recommendations closed	Number of open recommendations
	Total areas rated	Unsatisfactory		
Ghana	6	2	78%	11
Sudan	7	2	79%	15
Gambia	6	2	60%	13

45. An audit of consultancy contracting was completed in 1999, and the revised guidance for contract review committees issued by DFAM in 2001. New procedures for developing agreements with NGOs issued by Programme Division in 2001 address important control issues identified in that audit. Forty per cent of the recommendations directed to the Division of Human Resources are closed and the Division's plan to issue new guidance on consultancy management by the end of 2002 is expected to address the balance of the recommendations.

46. In early 2001, OIA issued an analysis of the bank reconciliation process in field offices and identified weaknesses that have contributed to the failure to detect several fraudulent actions. Management has accepted the recommendations and is taking actions in 2002 to address them, although eight of the nine recommendations remain open.

V. Standards of internal control in UNICEF

47. Based on the field and headquarters audits implemented in 2001 and a review of the actions reported by management to address the audit recommendations issued between 1999 and 2001, it is the conclusion of OIA that overall, UNICEF maintained satisfactory control systems for the planning, commitment and expenditure of its resources and field-level support to UNICEF programmes of cooperation, although there is room for improvement in annual planning, office governance and field monitoring.

48. As shown in table 5 below, although only two field offices met the demanding standard required for an exemplary rating, the global profile is one of largely satisfactory risk management practices in all audited areas, except cash assistance. The 10 field offices with more than one unsatisfactory rating (noted in table 4) accounted for 30 of the 39 unsatisfactory ratings issued to field offices in 2001. Among those 10 offices, the only common area of weakness was the management of cash assistance, which was unsatisfactory in nine of those locations.

49. There is scope for strengthening the controls over management practices for cash assistance, particularly in the guidance provided by field offices to counterparts for the request and liquidation of cash assistance, guidance to field offices in how to assess counterparts' administrative and accounting capacity, and procedures within offices for the assessment of cash assistance requests and liquidations.

Table 5
Summary of risk management ratings by audited area for field offices, 2001

	Total offices audited	*Unsatisfactory*	*Satisfactory*	*Exemplary*
Finance	26	6	20	0
Programme	22	4	18	0
Cash assistance	25	13	11	1
Supply assistance	24	6	18	0
Consultancy management	19	5	13	1
Other (four areas combined)	27	5	22	0

50. In 2001, over 85 per cent of field offices demonstrated timely action to begin to establish adequate controls over the risks identified in the audit reports and as a result (and if all other conditions remain as found during the audit), most now have reasonable controls over areas that were once unsatisfactory. Management has demonstrated that actions are being taken to address the recommendations that remain open, although improvements can be made in the timely resolution of a higher percentage of recommendations.

51. The 2001 headquarters audits addressed key elements of the financial systems in New York and Copenhagen and the procurement system in Copenhagen, through which over 25 per cent of UNICEF annual expenditure was made in 2001. The audits found all but one of the existing controls to be satisfactory, and these controls have been further strengthened through the actions taken to address the audit recommendations. However, there is scope for improving the timely attention to audit recommendations in headquarters divisions related to procedural guidance and systems improvements to address common field office weaknesses in the management of consultancy contract management and the bank reconciliation process. Similar action is called for to support improvements in the management of cash assistance in field offices.